# EXHIBIT 219

VERTICAL GROUP

Equity Research

April 2, 2018

**Heather Jones** (804) 250-6707 heather.jones@vertgrp.com
**Brett Hundley, CFA** (804) 250-6956 brett.hundley@vertgrp.com
**Brandon Groeger** (804) 250-6964 brandon.groeger@vertgrp.com

# Protein & Dairy Roundup

## KEY TAKEAWAY

This weekend, China formally imposed tariffs on U.S. pork imports, among other items. We have written about the potential impact in multiple recent reports. Specifically, we have noted that mainland China represented about 6% of U.S. pork exports on a trailing 3-month basis (Nov-Jan) and approximately 1.4% of total production over the same time period. *According to trade data, the majority of pork exports to China are variety meats (essentially offal, such as head meat, feet, etc.)* and, according to the USMEF, China/HK added about $6/head to U.S. hog values in 2017; based upon our analysis, mainland China represented about 2/3 to 75% of that total. The value is likely still substantial, but we believe it is lower than the 2017 average would suggest as recent data shows slowing demand and anecdotal reports suggest further slowing in recent weeks. In our view, China's imposition of a tariff should not have a drastic impact on pork packer margins – we estimate the loss of China could potentially pressure the cutout by up to $2.50-$4/cwt, but a more likely outcome would be in the $2/cwt range, in our view.

The Tyson shares are down hard on the news and a competitor's downgrade. We view the reaction as overdone, particularly considering how robust pork margins have been of late, *even with China* already slowing demand. Utilizing the more narrow WCB measure, which represents much of Hormel and Tyson's capacity, *packer margins are currently tracking $15-$20/head higher than in 2017*. Further, assuming the likely impact from the loss of China ($2/cwt), but no corresponding movement in the hog price, we estimate *Tyson's EPS would be impacted by just $0.15-$0.20.*

Figures from the Hogs & Pigs report were mixed – some figures came in a little higher than expected, while others were essentially in line. The breeding herd came in at up 1.7% yr/yr (consensus 1.5%) and sow productivity up 1.4% (1.1%), while market hogs were up 3.3%, in line with expectations. Farrowing intentions (sows expected to birth) for the Mar – May period were revised down about 20bps and the June – Aug figures show 1.4% expansion. That, combined with higher litter productivity, points to 3%-ish growth in total production (head) in late 2018/early 2019.

If those figures are realized, projected packer capacity expansion would outstrip production growth beginning in late Q3/Q4 this year. Currently, packers have been able to offset much of the new production growth with lighter Saturday kills. For instance, during Q1 the average Saturday slaughter rate declined about 30% from the prior year, which we estimate effectively removed nearly 250bps from industry capacity (slaughter hog). That, combined with higher hog production, has yielded a better S/D balance for pork packers affording continued strong margins. We do not believe packers will be able to manage Saturday kills in late 2018/2019 as aggressively given the large reductions that have already been implemented. However, over the near-term, margins should remain relatively strong.

Q1 beef margins largely exceeded the year-ago period, but in recent weeks have fallen below the prior year. We do not expect this to continue as feedlot inventories at the end of February were the highest for that month since 2008 and nearly 10% higher than the prior year. In our view, feedlots will have to market cattle more aggressively to avoid severe back-ups, which should help afford more expansive spreads for packers. We believe 2018 beef packer margins will be robust.

## Consumer Foods & Agribusiness

HIGHLIGHTED COVERAGE

**Cal-Maine Foods**
CALM - $43.70 - Hold

**Dean Foods**
DF - $8.62 - Buy

**Hormel Foods**
HRL - $34.32 - Hold

**Post Holdings**
POST - $75.76 - Buy

**Pilgrim's Pride**
PPC - $24.61 - Buy

**Sanderson Farms**
SAFM - $119.02 - Buy

**Tyson Foods**
TSN - $73.19 - Buy